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No. 94-554

In the Supreme Court of the United States

OCTOBER TERM, 1994

BERT F. SCALES, INDIVIDUALLY AND AS TRUSTEE FOR THE BERT F. SCALES 1981 TRUST, ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER FOR MBANK ABILENE, N.A.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals erred in upholding a judgment dismissing petitioners' claims against the Federal Deposit Insurance Corporation (FDIC) on the ground that claims against the FDIC based on unwritten agreements are precluded by the common law *D'Oench, Duhme* doctrine.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-10a) is reported at 20 F.3d 654. The order of the district court (Pet. App. 13a) is unreported. The related opinion of the Texas Fourteenth Court of Appeals at Houston (Pet. App. 17a-125a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 17, 1994. A petition for rehearing was denied on June 24, 1994. Pet. App. 11a-12a. The petition for a writ of certiorari was filed on September 21, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case began in 1984 as a lender liability suit for breach of an oral promise, brought by Harry LeMaire, Richard Patton, and petitioners against Abilene National Bank (ANB) in Texas state district court. Pet. App. 4a. The plaintiffs alleged that, in January, 1982, Don Earney (ANB's chairman, chief executive officer and majority stockholder) orally promised that ANB would lend $3 million to Lingen Energy Corporation (an entity owned by LeMaire, Patton, and petitioners) to finance Lingen's oil and gas drilling program. *Ibid.* Although ANB's prior loans to Lingen had been fully documented in the bank's records, it is undisputed that this new $3 million loan commitment was never reduced to writing. Gov't C.A. Br. 6; Pet. App. 8a.

In June, 1982, when Patton and LeMaire first requested advances under the $3 million oral commitment, Earney advised them that because the FBI and bank examiners were presently reviewing ANB's records, he needed to delay funding the loan. Gov't C.A. Br. 7. In July, 1982, Earney notified Patton and LeMaire that the bank examiners had determined that ANB's outstanding loans to Lingen and its related companies exceeded ANB's statutory loan limits, and that he would therefore need additional time to restructure and fund the $3 million loan. *Id.* at 7-8. In August, 1982, however, Mercantile National Bank (MBank) acquired ANB in a federally assisted transaction, removed Earney, and appointed new management. *Id.* at 8. Patton and LeMaire attempted to obtain additional loans from MBank, but were told that no further loans could be made to Lingen without exceeding the bank's statutory lending limits. *Ibid.* Lingen ultimately failed for lack of funds to finance its drilling program. *Ibid.* The

approximately $8.3 million in principal that Lingen owed to MBank was never repaid. *Ibid.*

2. When MBank sought to collect on the Lingen debt, Patton and LeMaire filed suit against the bank, claiming, among other things, breach of contract, promissory estoppel, fraud, and violation of the Texas Deceptive Trade Practices Act (DTPA), Tex. Bus. & Com. Code Ann. §§ 17.41 *et seq.* (West 1987). Gov't C.A. Br. 3; Pet. App. 4a. Petitioners subsequently joined the suit as plaintiffs. Gov't C.A. Br. 3. In 1986, after a five-week trial, the jury returned a verdict for Patton, LeMaire and petitioners, and the state trial court entered a judgment on the verdict against MBank for approximately $69 million. Pet. App. 126a-130a.

3. On April 6, 1989, the Texas Court of Appeals for the Fourteenth Judicial District affirmed Patton's and LeMaire's recovery for promissory estoppel, reversed petitioners' breach of contract claims, petitioner Scales' fraud claim, and all but one of petitioners' DTPA claims, and reversed and remanded for retrial petitioners' remaining common law and statutory claims. Pet. App. 14a-16a. The only portion of petitioners' award that remained intact was their attorneys' fees award, which the Texas Court of Appeals affirmed. *Id.* at 14a.

4. On March 28, 1989, nine days before the Texas Court of Appeals rendered its judgment, the Comptroller of the Currency declared MBank insolvent, and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. Pet. App. 5a. On April 20, 1989, the FDIC filed a notice of substitution and removed the case to the United States District Court for the Southern District of Texas. *Ibid.* In January, 1993, after denying petitioners' motions to remand, the district court entered an order adopting as its own judgment the judgment of the

Texas Court of Appeals. *Id.* at 13a; Gov't C.A. Br. 4-5.[1] Petitioners and the FDIC filed cross-appeals.[2]

5. On appeal, the FDIC defended the district court's judgment on the grounds stated by the Texas Court of Appeals and argued, in the alternative, that petitioners' oral contract-based claims were barred as a matter of law under the doctrine enunciated by this Court in *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), and under its statutory counterpart, 12 U.S.C. 1823(e) (Supp. V 1993).[3] Gov't C.A. Br. 12, 17-19. The court of appeals permitted the FDIC to raise the *D'Oench, Duhme* doctrine for the first time on appeal, because it found that the "the FDIC

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[1] While the case was pending in federal district court, the FDIC settled with Patton and LeMaire. Gov't C.A. Br. 4.

[2] The FDIC appealed only that part of the Texas Court of Appeals' decision affirming the award of attorneys' fees to petitioners. Gov't C.A. Br. 38-39.

[3] Section 1823(e) provides:

> No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement—
>
> (1) is in writing,
>
> (2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,
>
> (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and
>
> (4) has been, continuously, from the time of its execution, an official record of the depository institution.

had neither opportunity nor occasion" to assert the common law defense before the district court. Pet. App. 6a, quoting *Union Fed. Bank* v. *Minyard*, 919 F.2d 335, 336 (5th Cir. 1990).[4] Turning to the merits, the court noted that, under *D'Oench, Duhme*, "a party cannot rely on an oral agreement between the bank's customer and the bank as the basis for defenses or claims against the FDIC." Pet. App. 8a. Recognizing that petitioners' claims are predicated entirely on an alleged oral promise by ANB to lend petitioners $3 million, the court found all of petitioners' common law and DTPA claims unenforceable as a matter of law. *Id.* at 8a, 10a.[5]

ARGUMENT

The court of appeals correctly applied the *D'Oench, Duhme* doctrine to bar petitioners' claims against the FDIC, which are based entirely on an alleged oral agreement with a failed bank. The court's routine application of the doctrine in this case conflicts with no decisions of this Court or of any other court of appeals.

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[4] The FDIC had, in fact, raised *D'Oench, Duhme* and Section 1823(e) before the district court in a motion for rehearing and/or to alter or amend the state court judgment. Gov't C.A. Br. 17. The district court, however, adopted the judgment of the Texas Court of Appeals "[f]or purposes of federal appellate procedure" without acting on the motion. Pet. App. 13a.

[5] The court did not reach the question whether petitioners' claims are precluded as well by 18 U.S.C. 1823(e). Prior to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183, Section 1823(e) applied only to the FDIC acting in its corporate capacity; it now also applies to the FDIC in its receivership capacity. The court of appeals found no need in this case to address the application of the revised Section 1823(e) because, under established Fifth Circuit precedent, "both the statutory and common law doctrines bar similar defenses and claims." Pet. App. 6a n.5.

1. Petitioners argue (Pet. 9-15) that by permitting the FDIC to raise the *D'Oench, Duhme* doctrine for the first time on appeal, the court of appeals violated petitioners' procedural due process right to challenge at trial the factual predicates of the defense as applied in this case. That argument is without merit.

Permitting the FDIC to raise *D'Oench Duhme* on appeal caused petitioners no prejudice in this case, because no further development of the factual record was required to determine that the doctrine bars petitioners' claims. As the court of appeals noted, "[i]t is uncontroverted that the claims in this suit are predicated on Earney's oral promise to loan [petitioners] $3 million." Pet. App. 8a. Petitioners have never asserted at any point in these proceedings that the agreement which they alleged was breached by ANB was based on anything but Earney's oral promise. *D'Oench, Duhme* precludes reliance on such an oral agreement between a bank's customer and a bank as the basis for claims against the FDIC. See *Langley* v. *FDIC*, 484 U.S. 86 (1987). The court of appeals therefore correctly held that petitioners' claims were barred as a matter of law.

Petitioners also err in contending (Pet. 10-11) that they should have been permitted discovery to determine whether a prudent bank examiner would have discovered in MBank's files some record of the trial court's judgment on the oral agreement.[6] In the absence of a

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[6] Petitioners contend (Pet. 3, 7, 12) that MBank rebuffed their attempts in discovery to obtain bank records that would have documented the existence of the $3 million oral loan agreement, and that MBank was subsequently sanctioned by the trial court for its refusal to produce those records. Petitioners' characterization of the discovery record is misleading. One of MBank's defenses at trial was that, because bank examiners had classified certain relevant loans as exceeding the bank's statutory lending limits,

written agreement between the ANB and Lingen, however, a bank examiner's knowledge about an oral promise made by the bank is irrelevant to the FDIC's defense under *D'Oench, Duhme*. See *Langley* v. *FDIC*, 484 U.S. at 94-95. As the court of appeals explained (Pet. App. 9a), in applying *D'Oench, Duhme*, "the relevant inquiry is whether the individual or institution lent itself to a transaction that is likely to mislead banking authorities." Thus, "[t]he focus is on the transaction between the bank and the borrower, not on the knowledge of the FDIC." Pet. App. 9a.[7]

Neither *Park Club, Inc.* v. *RTC*, 967 F.2d 1053, 1056-1058 (5th Cir. 1992), nor *RTC* v. *Daddona*, 9 F.3d 312, 321 (3d Cir. 1993), recognized a right to proceed to trial under circumstances in which the FDIC's defense under

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bank regulators had issued a cease and desist order prohibiting the bank from any further lending limit violations, which prevented the bank from lending Lingen additional funds. In the pre-trial process, the plaintiffs attempted to obtain copies of the cease and desist order. The bank resisted, claiming regulatory privilege. At trial, the bank attempted to introduce the cease and desist order into evidence. However, the plaintiffs objected because the order had not been made available to them in discovery. The trial court agreed with the plaintiffs and barred the order's submission into the record. Tr. 2630-2637. That discovery dispute had no bearing on, and in no way suggested, the existence of bank records documenting the oral $3 million loan commitment.

[7] Although one purpose of the *D'Oench, Duhme* doctrine is "to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets," *Langley* v. *FDIC*, 484 U.S. at 91, a second purpose is to "ensure mature consideration of unusual loan transactions by senior bank officials, and prevent fraudulent insertion of new terms, with the collusion of bank employees, when the bank appears headed for failure," *id.* at 92. Knowledge by the FDIC or state bank examiners of an alleged oral agreement has no bearing on the latter purpose.

D'Oench, Duhme has been established by the undisputed facts of a case. In *Park Club*, the district court had granted summary judgment to the RTC upon finding that the letter agreement through which the bank had committed to extend a loan had not been approved by the bank's board of directors or loan committee in conformity with 12 U.S.C. 1823(e)(3) (Supp. V 1993). The court of appeals agreed that loan agreements are not valid against the RTC (or FDIC) unless they meet the requirements of Section 1823, but reversed and remanded because, in its view, there was a disputed issue of fact as to whether the letter agreement had been approved by the bank's board or loan committee. 967 F.2d at 1056-1057. The court's refusal to rule summarily in the face of a disputed issue of material fact lends no support to petitioners' contention that a case may never be decided under *D'Oench, Duhme* as a matter of law.

In *RTC* v. *Daddona*, real estate developers raised lender liability claims as a defense to the RTC's claim for the balance due on their loan obligations to a failed thrift. The thrift had loaned the developers $2,230,000 for the acquisition of property pursuant to a written and duly authorized loan agreement. The developers contended that the thrift had also committed to provide (but had ultimately failed to provide) an additional $9 million for improvements and development. Although the developers conceded that the alleged $9 million commitment was not reflected in a discrete written agreement, they claimed that several writings that referenced the $2,230,000 loan contained language that implied the existence of an agreement for additional development loans. The district court granted the RTC's motion for summary judgment, finding that the writings referenced by the developers fell "far short of the certain and categorical requirements imposed by the *D'Oench*

Duhme doctrine and § 1823(e)," 9 F.3d at 315, and the court of appeals affirmed, *id.* at 320.

The court of appeals in *Daddona* specifically rejected the developers' contention that "*D'Oench, Duhme* and § 1823(e) do not require that the terms of an agreement be in writing but only that the existence of an agreement can be inferred from writings." 9 F.3d at 317. In the court's view, an agreement is in writing only if "the existence of the agreement * * * appear[s] plainly on the face of an obligation [and] the basic structure of that agreement—its essential terms— * * * also appear plainly on the face of that obligation." *Id.* at 319. The court concluded that the writings the developers pointed to "d[id] not create a genuine issue of material fact as to the existence of such a written agreement," because "[e]ven stretching the evidence beyond where it [could] reasonably be taken, the evidence at most indicat[ed] that the parties had already formed an oral agreement for future loans." *Id.* at 317. Because such an oral agreement is not enforceable, the court affirmed the judgment in favor of RTC. Applying that standard here the possibility that MBank's records might have contained documents evidencing the existence of the $3 million oral loan commitment creates no issue of fact as to the existence of a written agreement, and thus no warrant for denying the FDIC judgment as a matter of law.

2. Petitioners also err in arguing (Pet. 16-18) that, by rejecting their claims as a matter of law, the court of appeals employed the *D'Oench, Duhme* doctrine as an impermissible irrebuttable presumption. What borrowers face in *D'Oench, Duhme* is not a procedural bar, but rather "a substantive law that eliminates the defense [or claim] when it relies on an agreement that is not in writing." *RTC* v. *Dadonna*, 9 F.3d at 321. No additional

procedures could have changed the undisputed fact that the petitioners' purported loan commitment was never reduced to writing, or altered the legal consequences that flow from that fact.

3. Petitioners argue further (Pet. 17) that if the FDIC had been substituted as the defendant prior to the trial, petitioners would have had the opportunity to try the elements of the *D'Oench, Duhme* defense; they allege that denying them that opportunity because the FDIC was substituted after the trial impermissibly discriminates against them. The equitable *D'Oench, Duhme* doctrine barring the borrowers' reliance on oral agreements is the same, however, regardless of the stage at which the FDIC enters the litigation. Given the conceded absence of a written loan agreement, petitioners' claims would have been subject to summary dismissal at trial on the same legal grounds applied by the court of appeals.

4. Finally, petitioners argue (Pet. 19-20) that because no provision of the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.*, expressly permits the FDIC to raise the *D'Oench, Duhme* doctrine for the first time on appeal, the court of appeals' willingness to consider the doctrine constituted an application of federal common law, in conflict with this Court's holding in *O'Melveny & Myers* v. *FDIC*, 114 S. Ct. 2048 (1994). Contrary to petitioners' suggestion (Pet. 20), however, the court of appeals did not allow the FDIC to raise its *D'Oench, Duhme* defense for the first time on appeal "out of federal comity and common law." Rather, the Fifth Circuit exercised its discretion to invoke a general exception to its prudential rule that it will not hear arguments not initially raised in the district court. See Pet. App. 6a-8a; *FDIC* v. *Castle*, 781 F.2d 1101, 1105 (5th Cir. 1986) (consideration of substantive contentions even

though raised late in the proceedings is particularly appropriate where application of the law is clear); *Texas* v. *United States*, 730 F.2d 339, 358 n.35 (5th Cir.) (general rule is subject to exceptions on case-by-case basis), cert. denied, 469 U.S. 892 (1984).[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[8] See also *Baumann* v. *Savers Fed. Sav. & Loan Assoc.*, 934 F.2d 1506, 1510-1511 (11th Cir. 1991), cert. denied, 112 S. Ct. 1936 (1992); *FDIC* v. *Hadid*, 947 F.2d 1153, 1157 (4th Cir. 1991).